

NO. 46200-1-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

AMERICA'S CREDIT UNION, fka Fort Lewis Community Federal
Credit Union, a Washington corporation,

Plaintiff/Respondent,

v.

COUNTRYWIDE HOME LOANS, INC.,

Defendant/Appellant,

and

CHARLES D. SHELTON and KATHRYN E. SHELTON, husband and
wife; MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC.,
as nominee for Countrywide Home Loans, Inc.; and LIENHOLDERS 1
THROUGH 10,

Defendants.

ON APPEAL FROM PIERCE COUNTY SUPERIOR COURT
(The Hon. Stanley J. Rumbaugh)

APPELLANT'S OPENING BRIEF

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I. INTRODUCTION

This appeal presents a straightforward legal issue – whether the trial court erred by declining to apply the doctrine of equitable subrogation when the Sheltons refinanced in 2002, paying off a 1994 loan. Instead of holding that the 2002 lender, defendant Countrywide Home Loans, Inc. (“Countrywide”), should be in first position, the trial court held that plaintiff America’s Credit Union (the “Credit Union”), which had provided the Sheltons with a home equity line of credit in 2000¹, was in first position. The trial court should have held, pursuant to the doctrine of equitable subrogation, that Countrywide’s loan was in first position.

II. ASSIGNMENTS OF ERROR

Countrywide makes the following assignments of error:

A. The trial court erred when it concluded that the doctrine of equitable subrogation does not apply to this case. CP 196.

B. The trial court erred when it concluded that the Credit Union’s mortgage is in first lien position and Countrywide is a junior lienor. CP 196.

¹ Fort Lewis Community Federal Credit Union, the predecessor to America’s Credit Union, provided the Sheltons with the home equity line of credit.

C. The trial court erred when it granted summary judgment in favor of the Credit Union and denied summary judgment in favor of Countrywide. CP 195-97.

III. STATEMENT OF ISSUES

The following issues pertain to the Assignments of Error:

1. Whether the trial court erred when it concluded the doctrine of equitable subrogation did not apply because of the vague language of the transmittal letter from Countrywide to the Credit Union and the fact that the transmittal letter didn't specify that the Credit Union was entitled to cash the check only upon execution of a mortgage release or satisfaction of mortgage. CP 196 and 200.

2. Whether the trial court erred when it concluded the doctrine of equitable subrogation did not apply because there was no correspondence or documentation of how much it would cost for the Credit Union to file a mortgage release or satisfaction of mortgage. CP 200.

3. Whether the trial court erred when it concluded the doctrine of equitable subrogation did not apply because the Credit Union was overpaid by \$46 and change, which sounded like a math error, not a reconveyance fee. CP 200.

IV. STATEMENT OF THE CASE

The Sheltons own real property located at 17 Lapsley Drive, Dupont, Pierce County, Washington. CP 2. On or about February 25, 1994, the Sheltons borrowed \$98,250.00 from Knutson Mortgage Corporation (the “1994 Loan”). The 1994 Loan was secured by a deed of trust that was recorded with Pierce County. CP 41-46.

Six years after taking out the 1994 Loan, on or about February 16, 2000, the Sheltons entered into a home equity line of credit account with the Credit Union (the “2000 Loan”). CP 5-8. The Credit Union recorded a revolving credit mortgage with Pierce County securing the Sheltons’ indebtedness up to the amount of \$40,000.00. CP 11-15.

On or about December 31, 2002, the Sheltons refinanced and entered into a new loan with Countrywide (the “2002 Loan”). As part of the refinance transaction, the Sheltons paid off the 1994 Loan (\$87,255.38) and the 2000 Loan (\$38,934.93). CP 48-50 and 59. The payoff to the Credit Union resulted in a zero balance on the Sheltons’ home equity line of credit. CP 35.

As shown on the Title Commitment, at the time of the 2002 Loan, the 1994 Loan was first in priority, ahead of the 2000 Loan. CP 52-57. A new deed of trust in favor of Countrywide was recorded on December 30,

2002, CP 63-73, and a full reconveyance of the 1994 deed of trust was recorded on April 2, 2003. CP 75.

The Sheltons' home equity line of credit account with the Credit Union was not closed following the payoff in December 2002 and the Credit Union's mortgage was not released. The Credit Union alleges in the Complaint that the Sheltons continued to borrow on this line of credit following the December 2002 payoff and owed \$34,794.93 on the home equity line of credit as of February 14, 2012. CP 3.

The Sheltons refinanced again in 2006 (the "2006 Loan"). CP 77-80. As a result of the 2006 Loan, a new deed of trust in favor of Countrywide was recorded on April 21, 2006, CP 82-92, and a full reconveyance of the 2002 deed of trust was recorded on May 3, 2006. CP 94.

Both Countrywide and the Credit Union moved for summary judgment. CP 21-30 and CP 95-104. On November 1, 2013, the Court issued its oral decision granting the Credit Union's motion for summary judgment and denying Countrywide's motion for summary judgment. CP 190-94. The Court entered its Order on Cross Motions for Summary Judgment on November 15, 2013. CP 195-202.

On April 16, 2014, the Court entered a Stipulated Motion and Agreed Order to Certify Pursuant to CR 54(b). CP 209-12. This appeal followed.

V. ARGUMENT

A. Standard of Review

A motion for summary judgment is properly granted where there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. CR 56(c). The standard of review on appeal from an order on summary judgment is de novo. *Sane Transit v. Sound Transit*, 151 Wash.2d 60, 68, 85 P.3d 346 (2004). The appellate court engages in the same inquiry as the trial court. *Citizens for Responsible Wildlife Mgmt. v. State*, 149 Wash.2d 622, 630-31, 71 P.3d 644 (2003); *Herron v. Tribune Publ'g Co.*, 108 Wash.2d 162, 169, 736 P.2d 249 (1987).

City of Sequim v. Malkasian, 157 Wn.2d 251, 261, 138 P.3d 943 (2006).

B. The Trial Court Should Have Applied the Doctrine of Equitable Subrogation

What is equitable subrogation? “Borrowed from English courts of equity, equitable subrogation simply seeks to maintain the proper order of priorities.” *Bank of America, N.A. v. Prestance Corp.*, 160 Wn.2d 560, 564, 160 P.3d 17 (2007). Courts apply the doctrine of equitable subrogation liberally and in a variety of contexts. *Prestance*, 160 Wn.2d

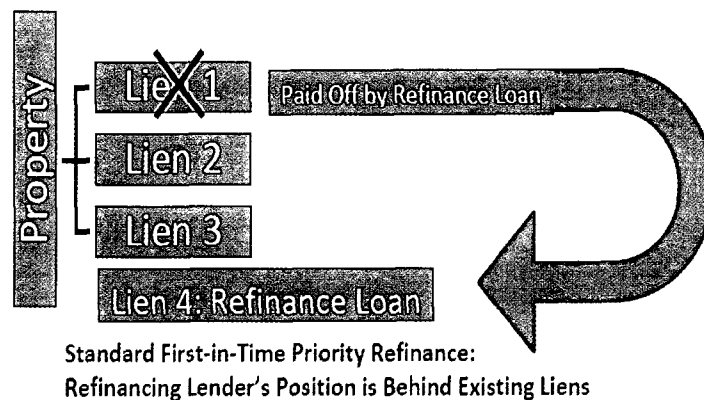
at 565 (“Despite an initial resistance to equitable subrogation, many courts now apply it liberally.”):

“The doctrine of equitable subrogation is an equitable one, having for its basis the doing of complete and perfect justice between the parties without regard to form, and its purpose and object is the prevention of injustice

It rests upon the maxim that no one shall be enriched by another’s loss, and may be invoked wherever justice and good conscience demand its application in opposition to the technical rules of law”

Id. at 565-66 (quoting *Cox v. Wooten Bros. Farms, Inc.*, 271 Ark. 735, 737-38, 610 S.W.2d 278, 280 (1981)).

The typical “first-in-time first-in-right” refinance transaction is illustrated in the graph below. In the first-in-time transaction, the refinancing lender takes a position behind all previously recorded liens because they are recorded ahead of the refinancing lender:



This system works, as long as the new lender knows about the other liens and expects to take a junior position behind all existing liens.

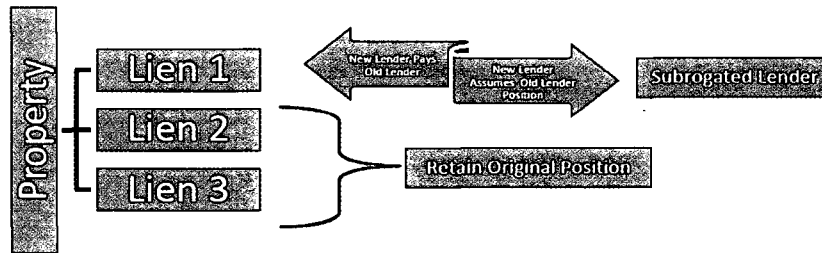
Equitable subrogation, on the other hand, allows all parties to retain their expected lien positions even if junior liens aren't paid. Under equitable subrogation, when a new lender pays off another lender's lien, the new lender assumes the priority and rights of the lien that it paid off, even if there are other lienholders with liens that recorded before the new lender. The new lender is simply substituted for the old lender and leaves all liens in the same position they had before the new lender paid off the old lender.

The Restatement (Third) of Property: Mortgages § 7.6(a) (1997) articulates the doctrine as follows:

One who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment. Even though the performance would otherwise discharge the obligation and the mortgage, they are preserved and the mortgage retains its priority in the hands of the subrogee.

Under the doctrine of equitable subrogation, once liens attach to a property, they retain that position until the debt associated with that lien has been extinguished by the debtor. Any new lender who pays the

balance of an existing lien assumes that lien's priority. It is the equitable equivalent of taking an assignment of an existing lien:



Equitable Subrogation Refinance: New Lender Assumes Old Lender Position. All Liens Remain in Original Priority

Equitable subrogation is different from the “first in time, first in right” doctrine based on recording dates. Equitable subrogation is concerned about preserving the lien rights and positions that *should* be on the property, regardless of recording dates. It elevates substance over form.

Equitable subrogation appears to be at odds with the principle of “first in time, first in right” because equitable subrogation allows a later creditor to assume priority over liens that would otherwise have priority under a “first-in-time first-in-right” theory. However, equitable subrogation is the best way to maintain lien priorities and prevent junior creditors from obtaining a windfall by getting a better lien position than they bargained for. The Washington Supreme Court used the following example:

For example, suppose *A*, a homeowner, has two mortgages: one recorded first by bank *B*

and one recorded second by bank *C*. Our recording act says *B* has a higher priority because it recorded first, putting the world on notice as to its interest in *A*'s land. RCW 65.08.070. If *D* fully discharges *B*'s debt, then equitable subrogation substitutes *D* for *B*, so *D* has a higher priority than *C*, even though *D* recorded after. ... At first blush, equitable subrogation conflicts with the recording act because it is an exception to the general rule "first in time, first in right." But no new lien or interest is created; *D* simply takes over *B*'s interest and that interest came first in time. *C* never expected his priority to be promoted simply because *A* refinanced the mortgage with a new company. *C* bargained with *A* to have a second-priority mortgage; it is immaterial who has priority before *C*.

Prestance, 160 Wn.2d at 564-65.

Equitable subrogation is also applied in order to prevent an unwarranted and unjustified windfall at the expense of another. Without it, creditors who had no expectation of a first lien position would "float to the top" and become senior to other lienholders. Equitable subrogation prevents this windfall by substituting one party for another "so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies, or securities." *Jackson Co. v. Boylston Mut. Ins. Co.*, 139 Mass. 508, 510, 2 N.E. 103, 104 (1885).

The Washington Supreme Court recently applied equitable subrogation in the mortgage refinancing context, and adopted the

Restatement (Third) of Property: Mortgages § 7.6. *Columbia Community Bank v. Newman Park, LLC*, 177 Wn.2d 566, 569-70, 577, 304 P.3d 472 (2013) (“in the context of mortgage refinancing, this court has generally permitted a lender to be subrogated to the position of a priority interest holder simply by paying off that priority interest holder’s loan”) (citing *Spokane Sav. & Loan Soc’y v. Park Vista Improvement Co.*, 160 Wash. 12, 27, 294 P. 1028 (1930); *Prestance*, 160 Wn.2d at 560).

The trial court should have applied the doctrine of equitable subrogation here.

C. The Trial Court Should Have Held That the Countrywide Lien was in First Position

Applying the doctrine of equitable subrogation, the trial court should have held that in 2002, when Countrywide paid off the earlier 1994 Loan, it became subrogated to the first lender’s interest as the lienor in first position.

In reaching its decision that equitable subrogation does not apply, the trial court focused on whether Countrywide instructed the Credit Union to release its mortgage, an issue that is irrelevant to the determination of whether or not equitable subrogation applies. The trial court noted that Countrywide sent a payment to the Credit Union, but its transmittal letter did not “specify that [the Credit Union] was entitled to cash the check only upon execution of a mortgage release or satisfaction

of mortgage” CP 222. The trial court also noted that there was no documentation or correspondence regarding how much it would cost to release the mortgage and “the fact that [the Credit Union] was overpaid by \$46 and change just sounds like a math error. These things are often moving targets so I’m not going to apply the Doctrine of Equitable Subrogation.” CP 222.

The trial court erred in focusing on whether Countrywide had instructed the Credit Union to release its mortgage in the 2002 refinance transaction. In *Finance Center Federal Credit Union v. Brand*, 967 N.E.2d 1080 (Ind. Ct. Appeals 2012), the court considered a fact pattern virtually identical to the facts here. In 2007, the Brands refinanced their first and second mortgages with GMAC Mortgage, LLC (“GMAC”); the second mortgage, as here, was a home equity line of credit from a credit union. At closing, a check was sent to the credit union to satisfy the amount owed by the Brands on their line of credit, but no notice was sent to the credit union requesting release of the lien, and the mortgage securing the home equity line of credit was not released. The credit union subsequently advanced additional funds to the Brands. In 2009, when GMAC sought to foreclose its mortgage, the credit union counterclaimed that its mortgage securing the home equity line of credit was first in priority and that it was owed over \$25,000. *Brand*, 967 N.E.2d at 1081-

82. The credit union argued that GMAC was not entitled to a first lien pursuant to the doctrine of equitable subrogation because GMAC was “culpably negligent in failing to obtain a release of the [credit union] mortgage” *Id.* at 1084.

The court rejected the credit union’s argument:

[A]ny negligence in GMAC’s failure to ensure that the Brands’ second mortgage with [the credit union] was released did not prejudice [the credit union] because [the credit union] mortgage was always junior to the senior Meridian Group mortgage, which was fully satisfied with the loan proceeds from the GMAC refinancing. Allowing GMAC to step into the shoes of the Meridian Group mortgage will leave [the credit union] in the very same junior position. This is a clearly equitable result. *See Nally*, 820 N.E.2d at 655 (“The mere fact that a person seeking subrogation was negligent does not bar him or her from relief where such negligence is as to his or her own interests and does not affect prejudicially the interest of the person to whose rights subrogation is sought.” (quotation omitted)). Although GMAC failed to ensure that the Brands gave proper notice to [the credit union] to release the lien, GMAC was not culpably negligent. The doctrine of equitable subrogation thus applies to this case.

Id. at 1085.

The Washington Supreme Court recently rejected culpable negligence or the “volunteer rule” as a bar to equitable subrogation in the

mortgage refinancing context, and adopted the Restatement (Third) of Property: Mortgages § 7.6, the same Restatement section that governed the decision of the Indiana court in *Brand*. *Columbia Community Bank*, 177 Wn.2d at 569-70 (“We now explicitly adopt *Restatement (Third)* § 7.6 in full.”); *see also Prestance*, 160 Wn.2d at 581 (“Equitable subrogation is a broad doctrine and should be followed whenever justice demands it and where there is no material prejudice to junior interests.”). Given the Supreme Court’s recent decisions in *Columbia Community Bank* and *Prestance*, it is plain that if faced with a fact pattern similar to the one in *Brand*, the Washington Supreme Court would rule the same way as the Indiana Court of Appeals ruled in *Brand*.

Here, as in *Brand*, the Sheltons refinanced in 2002, paying off a first loan and a home equity line of credit from the Credit Union. The documentary evidence establishes that the home equity line of credit was fully paid off – the HUD Settlement Statement refers to “Payoff of Existing Loans” and the monthly statement of the home equity line of credit shows a zero balance following the payment. However, the account was not closed, the Credit Union’s mortgage was not released, and the Credit Union subsequently advanced additional funds to the Sheltons. Now, after the Sheltons have defaulted on payment, the Credit Union

claims that its mortgage is entitled to first priority and seeks to foreclose based upon that purported position.

The Court should hold that the doctrine of equitable subrogation applies and thus Countrywide is entitled to first priority. The Credit Union's mortgage was junior to the original 1994 deed of trust. When the Sheltons refinanced with Countrywide in 2002, Countrywide stepped into the first lender's position. Countrywide remained in first position following the 2006 refinancing for the same reason. Allowing Countrywide to step into the first lender's shoes leaves the Credit Union in the same position it was in originally and is clearly equitable. Thus, although it appears that Countrywide may have failed to give notice to the Credit Union in 2002 to close its home equity line of credit, Countrywide was not culpably negligent. Because the doctrine of equitable subrogation applies in these circumstances, the Court should hold that Countrywide's deed of trust has first priority.

In addition, although it is generally true that equitable subrogation is only applied to the extent of payment of the first lien (here, \$87,255.38) plus interest and attorneys' fees, equity here demands that Countrywide be subrogated to the extent of its entire 2006 lien (\$224,000.00). The documentary evidence demonstrates that the parties intended the payoff in 2002 of the home equity line of credit to result in closing the account and

releasing the mortgage. The payoff was listed on the HUD Settlement Statement as a “total payoff.” CP 48-50. The account went to a zero balance following the payoff. CP 35. The transmittal letter from Countrywide to the Credit Union enclosed the check “which includes reconveyance fee.” CP 61. Under these circumstances, the Court, sitting in equity, should find that a reconveyance should have occurred, the account should have been closed and the mortgage should have been released. *E.g., Rennebohm v. Rennebohm*, 153 Wash. 102, 107, 279 P. 402 (1929) (court of equity has the power to order a reconveyance); *see also Elsom v. Tefft*, 140 Wash. 586, 591, 250 P. 346 (1926) (“it is well settled that a court of equity has power to compel a reconveyance of property outside of its jurisdiction”).

Accordingly, the Court should hold that Countrywide, as subrogee, is in first position to the full extent of its 2006 lien, \$224,000.00.

VI. CONCLUSION

The trial court erroneously granted the Credit Union’s motion for summary judgment and should have granted summary judgment in favor of Countrywide. Countrywide respectfully requests that this Court reverse the trial court’s ruling and instead order the entry of summary judgment in favor of Countrywide. The Court should rule that, based on the doctrine of equitable subrogation, Countrywide is the senior lienor, ahead of the

Credit Union, to the full extent of Countrywide's 2006 lien, \$224,000.00.

Alternatively, the Court should hold that Countrywide is subrogated to the extent of the 2002 payoff to the first lender, \$87,255.38, plus interest and attorneys' fees.

DATED this 14th day of August, 2014.

A handwritten signature in cursive script, appearing to read "Janis G. White", is written over a horizontal line.

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CERTIFICATE OF SERVICE

I hereby certify that on the date given below I caused to be served the foregoing document entitled **APPELLANT'S OPENING BRIEF** on the following individuals in the manner indicated:

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SIGNED this 14th day of August, 2014, at Seattle, Washington.


Shbien Cross, Legal Assistant